SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 1323

CONTINENTAL OIL COMPANY, TIDEWATER OIL COMPANY, ATLANTIC RICHFIELD COMPANY, CITIES SERVICE OIL COMPANY, *Petitioners*

v.

FEDERAL POWER COMMISSION, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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TABLE OF CONTENTS

	Page
Table of Citations	ii
Opinions Below	2
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement	3
Reasons for Granting the Writ	3
A. Holding Below Nullifies Rayne Limitations	5
(1) Ship Shoal Reserves Not Proven or Substantially Developed	6
(2) Ship Shoal Not a "Sale" in Economic Effect on Parties	10
(3) Ship Shoal Not a Sale "in Interstate Commerce of Natural Gas for Resale"	12
(4) Only One Short Step to Jurisdiction Over All Lease Transfers	14
B. Federal Law Forecloses Holding The Ship Shoal Transaction to Constitute a Sale of Gas	15
Conclusion	21
APPENDICES:	
A—Statutory Provisions Involved	1a
B—Opinions, Decrees, and Orders Below	1b

TABLE OF CITATIONS

CASES: Page

The Atlantic Refining Company v. Public Service Commission of the State of New York, 360 U.S. 378 (1959) 13

Federal Power Commission v. Pan American Petroleum Corporation, 381 U.S. 762 (1965), rev'g, 339 F.2d 694 (10th Cir., 1964) 6

Federal Power Commission v. Panhandle Eastern Pipe Line Co., 337 U.S. 498 (1949) 2, 5, 15

Frost-Johnson Lumber Co. v. Salling's Heirs, 150 La. 756, 91 So. 207 (1923) 18

International Text-Book Company v. Pigg, 217 U.S. 91 (1910) 13

United Gas Improvement Company v. Continental Oil Company, 381 U.S. 392 (1965) 2, 4, 5, 6, 10, 14, 15, 18, 19, 20

FEDERAL POWER COMMISSION OPINIONS AND ORDERS:

Tennessee Gas Pipeline Company, *et al.*, CP65-356, *et al.*, decision issued December 15, 1966 15

Texas Eastern Transmission Corporation, 29 FPC 249 (1963) 10

STATUTES:

Natural Gas Act, 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-717w (1964)

Generally 2, 4, 5, 16, 18, 19, 20
Section 4(c) 2, 1a
Section 7(c) 2, 1a
Section 19(b) 2

Outer Continental Shelf Lands Act, Act of August 7, 1953, 67 Stat. 462, 43 U.S.C. 1331, *et seq.* (1964)

Generally 2, 3, 4, 15, 16, 17, 18, 19, 20
Section 4(a)(1) 2, 18, 19, 3a
Section 4(a)(2) 2, 18, 3a
Section 5(a)(1) 2, 16, 4a
Section 5(c) 2, 16, 5a

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners[1] pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case, entered December 19, 1966.

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[1] Petitioners are Continental Oil Company, Tidewater Oil Company, Atlantic Richfield Company (Formerly The Atlantic Refining Company), and Cities Service Oil Company.

OPINIONS BELOW

The opinion of the Court of Appeals (App. B, *infra*, pp. 1b-20b) is reported at 370 F.2d 57. Its order denying rehearing (App. B, *infra*, p. 23b) is not reported. The order of the Federal Power Commission (J.A. 641-5)[2] is reported at 32 F.P.C. 1167. Its order denying rehearing (J.A. 645-9) is reported at 32 F.P.C. 1487.

JURISDICTION

The judgment of the Court of Appeals (App. B, *infra*, pp. 21b-22b) was entered December 19, 1966. Its order denying rehearing (App. B, *infra*, p. 23b) was entered January 27, 1967. Jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

As now limited under opinions of this Court,[3] the Commission's jurisdiction over lease transfers is confined to those which cover "proven and substantially developed" reserves, which are "close in economic effect" to gas sales, and which are made in "interstate commerce for resale." Under the Outer Continental Shelf Lands Act (OCSLA),[4] Petitioners were issued leases covering two 5,000-acre tracts in the Ship Shoal Area, Offshore Louisiana. In 1955, one gas well had

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[2] J.A. references are to the Joint Appendix in the Court of Appeals.

[3] *Rayne* [*United Gas Improvement Company* v. *Continental Oil Company*, 381 U.S. 392 (1965)]; *Panhandle* [*Federal Power Commission* v. *Panhandle Eastern Pipe Line Company*, 337 U.S. 498 (1949)].

[4] Act of August 7, 1953, 67 Stat. 462, 43 U.S.C. 1331, *et seq.* (1964).

been completed thereon and is now shut-in with no gas produced. From 34 to 40 additional completions were then anticipated for development. Out of such leased tracts, Petitioners transferred vast acreage, along with the single gas well. These transfers were approved as assignments of leases by the Secretary of the Interior in whom Congress had vested exclusive jurisdiction to administer OCSLA. The Commission did not and could not make findings articulated with the foregoing limitations fixed by this Court.

(1) Apart from OCSLA, can the Commission regulate the lease assignments as sales of gas?

(2) Confronted with OCSLA, can the Commission appropriate power to nullify official actions of the Secretary approving the transfers as assignments of leases?

STATUTES INVOLVED

The statutory provisions involved include Sections 4(c) and 7(c) of the Natural Gas Act, 52 Stat. 822, 825 (1938), as amended, 15 U.S.C. 717(c), 717f(c) (1964) and also Sections 4(a)(1)(2), 5(a)(1), and 5(c), 67 Stat. 462 (1953), 43 U.S.C. 1333(a) (1)(2); 1334(a)(1) and 1334(c). They are printed in App. A, *infra,* pp. 1a-5a.

STATEMENT

In 1955, subject to the provisions of OCSLA, Petitioners were granted two 5,000-acre leases in the Ship Shoal Area, Offshore Louisiana, by the United States of America (J.A. 90-121). For these leases they paid over $11,000,000 (J.A. 90, 105).

One gas well has been completed; it has been and still is shut-in with no gas produced (J.A. 4-5). Seven

oil wells had been completed and have been producing since 1960 *(ibid.)*. Four dry holes had been drilled *(ibid.)*.

In 1961, for a consideration of over $97,000,000 (J.A. 30), Petitioners transferred the oil leasehold interests under portions of the leases to Tenneco Oil Company and the gas leasehold interests to Tennessee Gas Supply Company (J.A. 23-4, 51-2, 588). These transfers were duly approved as properly qualifying as lease assignments under OCSLA and the regulations of the Secretary of the Interior thereunder (J.A. 604-6).

Following a hearing upon a Commission order directing the Petitioners to show cause why they should not be required to comply with the requirements of the Natural Gas Act, the Commission determined the lease transfers to be sales of gas in interstate commerce for resale and issued the order here under review (J.A. 614-6, 641-5). It denied rehearing and directed that Petitioners make appropriate filings (J.A. 645-9).

The Court below affirmed on the ground that this case is governed by this Court's holding in *Rayne*.[5]

REASONS FOR GRANTING THE WRIT

The opinion below presents two novel questions which are important in the administration of the Natural Gas Act and OCSLA. The first is whether the new criteria prescribed will nullify the limitations laid down by this Court in *Rayne*, expanding Commission jurisdiction to substantially all trading in leases. The second is whether an irreconcilable conflict is created between the Natural Gas Act and OCSLA.

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[5] *Supra*, n. 3.

A. Holding Below Nullifies Rayne Limitations

In *Panhandle,*[6] it was held that "leases are an essential part of production" and that their transfer is beyond the coverage of the Act which exempts production and gathering. In *Rayne,*[7] this Court was careful not to overrule *Panhandle,* but confined it to the facts there involving a transfer of "undeveloped leases" and not involving a "sale of natural gas for resale in interstate commerce."

The resulting rule in *Rayne* limited Commission jurisdiction over lease transfers to those where (1) the gas reserves underlying the leases are "proven and substantially developed," (2) the lease transfer is close to a gas sale in its "economic effect" upon the parties, and (3) the lease transfer is a sale of gas in "interstate commerce for resale."[8]

The Court below recognized this as the three-pronged test of *Rayne (infra,* p. 8b), concluding that:

> "The crucial fact here, as in Rayne, is that the assignment of the leases accomplished the transfer of large amounts of substantially proven off-shore natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production—even if there has also been a transfer of an interest in real property" *(infra,* p. 20b).

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[6] 337 U.S. at 505, 515.

[7] 381 U.S. at 403-4.

[8] 381 U.S. at 396-400.

However, these sweeping judicial conclusions do not rest upon findings of the Commission and are demonstrably contrary to the facts.

(1) *Ship Shoal Reserves Not Proven or Substantially Developed.*—The Commission did not and could not find that the Ship Shoal reserves were "proven." Nor did it or could it find that such reserves were "substantially developed."

Under accepted and unquestioned industry definitions, proven reserves are those shown to be recoverable with "reasonable certainty."[9] There was *no* evidence that reserves underlying the vast acreage were "proven." The impossibility of such a finding is underscored by the fact that only one gas well had been completed, no gas had been produced, and at the time of transfer 34 to 40 completions were anticipated for development (J.A. 38). The Commission correctly found, therefore, that Tennessee obtained an "unascertained amount of gas," since it could not "tell how much gas it is getting," and that it was accordingly getting a "pig in a poke," as the Commission graphically put it (J.A. 630).

The facts here thus stand in sharp contrast to *Rayne* and to *Bastian Bay.*[10] As the Court below recognized, the Commission had held Rayne to be "fully developed"

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[9] See, *e.g.*, Society of Petroleum Engineers, "Journal of Petroleum Technology," p. 815, July, 1965; "Proven Reserves of Crude Oil, Natural Gas Liquids and Natural Gas," p. 6, December 31, 1964, published jointly by the American Gas Association, Inc., the American Petroleum Institute, and the Canadian Petroleum Association.

[10] *Federal Power Commission* v. *Pan American Petroleum Corporation*, 381 U.S. 762 (1965), rev'g, 339 F. 2d 694 (10th Cir., 1964).

(infra, p. 13b). It likewise recognized the contrast to Bastian Bay where the seller had drilled 32 wells and achieved 21 oil completions and 20 gas completions *(infra,* p. 13b). But here there is no denying that the "properties were a long ways from being developed" (J.A. 38).

In this dilemma, the court below devised a new test to confer jurisdiction, one quite different from the "proven and substantially developed" test fixed by *Rayne.* This new test is:

> "Have the leaseholds been sufficiently proved and developed for imminent production of natural gas in commercial quantities? Two criteria emerge from this standard. One is definability of gas volume based upon proof of reserves; the other is imminent ability to produce in commercial quantities" *(infra,* p. 12b).[11]

As for imminence of production at the time of transfer in 1961, no gas has been produced in the six succeeding years. Neither this test nor the "commercial quantities" test was even mentioned or suggested by the Commission. The latter test was first suggested by counsel for the Commission in an obvious effort to escape the effect of the absence of substantial development at Ship Shoal.[12] But neither they nor the court below suggested what might be the compass of the "com-

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[11] The court below added that the Commission had made "numerous findings" justifying the court's holding that the leases were "proven and substantially developed." Such findings were not and cannot be identified.

[12] See "Brief for Federal Power Commission," filed in the court below, p. 16.

mercial quantities'' test.[13] In any event, no such determination was made here.

As a substitute for facts permitting a determination of substantiality of development, the court below turned to Tennessee's "faith" that reserves could be found as hoped, and its "readiness" to connect its lines to Ship Shoal (*infra,* pp. 14b-16b). It is true that Tennessee risked a payment of over $97,000,000 for the oil interests, when seven oil wells had been completed, and for the gas interests, when only one gas well had been completed. But if such "faith" were an acceptable substitute for substantiality of development, the lease by the United States to Petitioners would have become a conventional sale of gas, since Petitioners risked a payment of over $11,000,000, prior to *any* oil or gas exploration and development (J.A. 90, 105). Moreover, the record shows without dispute that the shorter the production history of a field, the less fully it is developed and the wider will be the variations in reserve estimates (J.A. 39-40, 77); here there is *no* history of production. Such variations will be greater until a

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[13] It is clear that the court below had a very confused understanding of gas volumes. By way of illustration, in their petition to the court below for rehearing, Petitioners noted:

> "It is evident in any event that the Court has a confused concept of gas quantities generally. For example, witness its reference to the 65,000 MMcf of natural gas taken by Texas Eastern from Rayne prior to January 1, 1961, as '65,000 Mcf' (Slip Opinion, p. 16), its reference to the 990,000 MMcf of total estimated recoverable Rayne reserves as about '990 Mcf' (*ibid.*), and its reference to Tennessee's estimate of 550,000 MMcf of net reserves recoverable from Ship Shoal as '550 Mcf' (*id.*, p. 17), among other gas volume errors" (p. 4).

Some but not all of these illustrative volume errors were later corrected in the subsequently printed version of the opinion of the court below.

field is fully drilled up so that the areal extent is known and there is production history over a period of years under operating conditions (J.A. 15-6); here there has been no gas production.

The court below sought support from the fact the contract redetermination provision specified a gas reserve figure (*infra*, pp. 4b-5b, 14b-15b). But the evidence is undisputed that this figure served "only as a base for computing the purchase price adjustment following redetermination," being merely "an arbitrary figure acceptable solely for this purpose" (J.A. 6, 29). It did not represent an "agreement" among the parties as to reserves (J.A. 29). It thus has no inherent engineering significance as to reserves present in fact, but is instead merely a component for use in redetermination at the end of the seventh year (*ibid.*). It therefore lacked even tentative significance as an estimate. Indeed, from an engineering standpoint, the parties could not have ascertained a definite or definable volume of gas at the time of transfer (J.A. 7).[14]

Nor can the court below gain support from its assertion that Tennessee was "ready" to connect the Ship Shoal reserves. Putting aside its reliance here upon matters *dehors* the record, the court below overlooked the fact that Tennessee would be compelled to proceed with development work following the transfer. Thus, it could not determine until later whether to construct

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[14] The court below asserted that Petitioners had "conceded" that such a determination "down to the last cubic foot" could not be made even after a well has been fully depleted (*infra*, p. 15b). This is no concession. It is merely a truism deriving from the fact that an undefinable volume of gas will remain in the reservoir after depletion, since only a portion of the reserves is recoverable (J.A. 8-10).

the connecting pipeline, depending on the results from further drilling to determine economic feasibility.

(2) *Ship Shoal Not a "Sale" in Economic Effect on Parties.*—This Court held that the *Rayne* lease-sale agreements "were such that they were very close in economic effect to conventional sales of natural gas." [15] Fifteen—essentially all—of the economic factors considered and enumerated by this Court in *Rayne* do not appear here.[16] In *Rayne,* the Commission expressly held that the difference between the conventional sale and the successor leasehold transfer is a difference "solely in the contractual arrangements." [17] Such a finding was not and could not be made here.

In holding that in economic effect the Ship Shoal lease transfers do not "differ enough" from a conventional sale to defeat Commission jurisdiction, the court below dealt with only a few aspects (*infra,* pp. 8b-11b). As to these, it overlooked entirely the substantive variance in economic consequences.

First, noting that Petitioners called for and received separate offers for conventional sales and for lease transfers, the court concluded that the $1,149,000 difference, available to *each* Petitioner, between the estimated cash flow under a gas sale and that under a lease sale is not a "significant difference," but goes "more to the method of payment" (*infra,* p. 9b).

But far more is involved than method of payment. The million dollar difference is founded upon differ-

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[15] 381 U.S. at 396.

[16] 381 U.S. at 395-7.

[17] *Texas Eastern Transmission Corporation,* 29 F.P.C. 249, 251 (1963).

ences in economic consequences. The court below failed to recognize the economic impact of the fact that Petitioners had to participate in further lease acquisitions, requiring large sums of money, if they wished to maintain their position in the offshore area (J.A. 13); that they wanted to get their investment back as soon as possible (*ibid.*); that they wanted the quick cash from the downpayment and an early payout through the relatively short period of installment payments (J.A. 14); that a lease transfer entailed a 25 per cent capital gains tax rate, as compared with a 52 per cent rate under continuous operations (J.A. 20); that earnings under a conventional sale would be received over a period upward to thirty years, in contrast with total payment under a lease transfer within seventeen years (*ibid.*); that earnings received after twenty years have relatively little value today (*ibid.*); and that no additional investment in development through additional wells would be necessary under a lease transfer (J.A. 20, 37).

Moreover, the million dollar difference for each Petitioner represents part of the additional consideration the purchaser was willing to pay for his expectation that the oil and gas found would be more than sufficient to justify the total purchase price, in sharp contrast to a conventional sale where the prospect of such benefits or detriments is left with the seller.

Second, although expressly aware that the *Rayne* lease sales covered no minerals except natural gas and condensate and that the sellers were to continue the bulk of the production work, the court below nevertheless brushed aside the fact that the Ship Shoal transaction conveyed *all* mineral interests and vested control *exclusively* in the buyer (*infra,* pp. 9b-11b). It

apparently rested this conclusion solely upon the fact that Tennessee was given an option to require Petitioners to purchase any crude oil produced at the average posted price, the court saying:

> "This may not be a 'wash sale' in the usual sense, but it is clear that Catco's obligation to repurchase the crude oil represents a significant retained interest in Ship Shoal" (*infra*, p. 10b).

Here again, the court below overlooked the decisive economic difference from *Rayne* in that Tennessee assumed the entirety of the gamble that more or less than enough oil would be recovered to justify the purchase of the oil leasehold interests, regardless of who might buy the oil when produced.

Third, still other economic differences were overlooked by the court below. For example, it disregarded totally the uncontroverted, extensive, and detailed testimony of an outstanding banker—based on many years of experience in financing oil and gas operations—that the Ship Shoal lease transfers are assignments of leases in their financial effect and impact upon the parties and that they do not in the least resemble sales of gas (J.A. 62-77).[18]

(3) *Ship Shoal Not a Sale "In Interstate Commerce of Natural Gas For Resale."*—In holding that the Ship Shoal lease transfers constitute sales of gas "in interstate commerce of natural gas for resale"—a pre-

[18] It also disregarded entirely the uncontroverted expert testimony of a distinguished Louisiana lawyer, based upon a careful and detailed analysis of the Ship Shoal transaction, that it is comprised of transfers of leasehold interests and not of sales of gas, a conclusion which he rested upon four different groups of specific legal considerations (J.A. 86-9).

requisite to Commission jurisdiction—the court below relied upon two considerations. Posing the question whether the transfer was "for purpose" of interstate transmission and sale (*infra*, p. 8b), it said that Tennessee had shown an "unequivocal intention" to connect the reserves with its interstate system (*infra*, p. 17b).

But jurisdiction does not rest on the transitory state of mind of a party to the transaction. It has long been established that "Importation into one state from another is the indispensable element, the test, of interstate commerce." [19] Here, there has been no production and no movement of gas anywhere.

In such circumstances, this Court has held that not even the filing of a certificate application for authority to make a sale in interstate commerce of natural gas for resale can constitute a "dedication to the interstate market of the gas recoverable under these leases." [20] Hence, it is not possible to make the prerequisite finding that any gas produced will be sold in interstate commerce for resale or that it *"will have to be transported across state lines for sale"* (*infra*, p. 17b, court's emphasis). For Tennessee would be free to make a nonjurisdictional sale of gas for direct industrial consumption, if and when any is produced. Or it could use any such gas for its own nonjurisdictional consumption, as in a chemical or fertilizer plant. Or

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[19] *E.g., International Text-Book Company* v. *Pigg*, 217 U.S. 91, 107 (1910).

[20] *The Atlantic Refining Company* v. *Public Service Commission of the State of New York*, 360 U.S. 378, 387 (1959). The court below thus assumed the point at issue in observing that the Commission "cannot abstain from exercising jurisdiction of petitioners' sales" because certificates might be rejected if issued (*infra*, p. 18b).

it could make a nonjurisdictional disposition through on-site liquefaction and transportation to countries outside the United States, never crossing any state line.

Here, there can be no certainty that any gas will ever be sold in interstate commerce for resale. Not so in *Rayne*. There, soon after completion of the 1958 lease sales, Texas Eastern began to receive gas for interstate transportation; when the Commission asserted jurisdiction and at the time of judicial review there had been several years' history of transportation and sale in interstate commerce for resale (381 U.S. at 397). Here, even now no gas has been produced, sold, or moved anywhere.

(4) *Only One Short Step to Jurisdiction Over All Lease Transfers.*—As shown above, acceptance of the opinion of the court below would subvert both the form and substance of the tests established in *Rayne*. In turn, this would lead to an expansion of jurisdiction to cover all lease transfers.

In *Ship Shoal,* the Commission did not and could not find that the reserves are either proven or substantially developed. In an attempt to fill that void and support the Commission's assertion of jurisdiction, its counsel proposed their own "commercial quantities" test. In adopting that test, the court below announced two criteria: "definability of gas volume based upon proof of reserves" and "imminent ability to produce in commercial quantities." The Ship Shoal facts plainly do not permit satisfaction of the first criterion, and it is significant that neither the Commission nor the court endeavored to articulate any such criterion with those facts. This is also true of the second criterion, and we suggest that it is not satisfied by the

court's resort to Tennessee's "faith" or its "readiness" to connect.

If the need to show that the reserves are "proven and substantially developed" can be satisfied by the presence of a single well on vast acreage transferred, with not one Mcf produced, there remains but a very short step to jurisdiction over all lease transfers. And despite this Court's limiting preservation in *Rayne* of the rule of *Panhandle*,[21] that rule would then be obliterated, along with *Rayne's* limitations, a course already being charted to jurisdiction over all lease transfers.[22]

B. Federal Law Forecloses Holding the Ship Shoal Transaction To Constitute a Sale of Gas

Independently of *Rayne* and the considerations discussed above, there is yet another bar to commission control over the Ship Shoal lease transfers. Holding that the Commission has jurisdiction over a transfer of leases issued under OCSLA, the Commission and the court below have adopted an interpretation of OCSLA

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[21] *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949).

[22] Witness the Presiding Examiner's legislative dissatisfaction with *Rayne* and *Panhandle* in his initial decision, issued December 15, 1966, in *Tennessee Gas Pipeline Company, et al.*, Docket Nos. CP65-356, *et al.*, mimeo. ed., p. 37:

> "5. The 1949 Panhandle case contains no language whatsoever that warrants a distinction between 'developed' and 'undeveloped' leaseholds as a *ratio decedendi*. The distinction simply does not exist except as a part of *Rayne Field*; a part which on sufficient showing, the Supreme Court will no doubt eliminate. The fact is that the 1949 Panhandle case has been moribund ever since *Phillips* and even before; the breath of life that remains has been pumped in by the Court's acceptance of a legalistic distinction-without-a-real-difference pressed upon the Court by Government counsel."

which needlessly places it in irreconcilable conflict with the Natural Gas Act, contrary to the established requirement that such a conflict be avoided where possible.

The holding below would invest the Commission with power to destroy the authority of the Secretary of the Interior under OCSLA. Congress vested in the Secretary of the Interior the duty to administer the provisions of OCSLA "relating to the leasing of the outer Continental Shelf" and to prescribe the necessary rules and regulations.[23] And it is affirmatively evident that Congress did not make this delegation in 1953 without an awareness of the authority it had vested in the Commission in the 1938 Natural Gas Act. For in OCSLA it delegated to the Commission certain limited duties in connection with conditions in pipeline rights-of-way,[24] but none with respect to leases.

The uncontroverted and only relevant evidence of record shows that the Ship Shoal transaction properly qualified as assignments of leases under OCSLA and the applicable regulations. They served to achieve the changes in the relationships among the parties in the manner contemplated by such a property transfer, in contradistinction to what their rights would be under the OCSLA regulations if the transaction were to be construed a sale of gas. The Manager of the Bureau of Land Management in New Orleans advised that the proposed transaction would constitute an assignment of leases but that certain features would require approval by both the Director and the Secretary (J.A. 54-5). Accordingly, the obtaining of the required ap-

[23] 43 U.S.C. 1334(a)(1); *infra*, pp. 4a-5a.

[24] 43 U.S.C. 1334(c); *infra*, p. 5a.

proval was made a condition precedent to the completion of the assignment (J.A. 56). As finally drawn, the assignments were accorded the necessary official approval by the Director and Acting Secretary, and the record title was found to be held by the assignees (J.A. 600-3).

But the Commission could obviously direct that all of these transfers be undone if, as the court below held, it had jurisdiction to regulate each transaction as a conventional sale. For the Commission would need do no more than refuse the certificate which would then be required, thus nullifying entirely the authority of the Secretary as established by Congress in OCSLA. It is manifestly impossible for a transaction to be, at once, a Secretary-approved transfer of leases and a Commission-disapproved application for authority to make a conventional sale of gas.

Significantly, the court below ignored entirely this demonstrated incompatability between the two statutes arising from the court's interpretation.[25]

For an additional and separate reason, the Commission and the court below erred in holding that the transfer of the Ship Shoal leases under OCSLA can

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[25] There would be a vast difference in the economic consequences upon Petitioners as lessors. Since the transaction was treated as a transfer of leases, they were required to pay, in addition to regular royalty payments, a minimum payment of $3.00 per acre because the leases were segregated as to oil interests and gas interests (J.A. 58). As to the unassigned acreage below the M-1 sand, they were required to pay a total of $30,000.00 a year in minimum royalty or rental payments (*ibid.*). But if the transaction be construed as a conventional sale, with the products treated as "production," Petitioners presumably would immediately have become liable for royalty of 16⅔ per cent of the value of the products sold (J.A. 93-5). The total consideration was $97,333,333 (J.A. 30).

be treated as a conventional gas sale regulable under the Natural Gas Act. Under OCSLA, Congress extended the coverage of the Constitution and laws of the civil and criminal jurisdiction of the United States to the Outer Continental Shelf "to the same extent as if the outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State: *Provided, however,* That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of" OCSLA.[26] To the extent applicable and not inconsistent with OCSLA or other federal laws or regulations of the Secretary of the Interior, Congress declared that the civil and criminal laws of each adjacent state to be the law of the United States for that portion of the subsoil and seabed of the Outer Continental Shelf, which would be within the area of the state if its boundaries were extended seaward to the outer margin of the Outer Continental Shelf.[27] In this case, Louisiana is the adjacent State.

Absent any inconsistency thus proscribed, therefore, the law of Louisiana was declared by Congress to be federal law for purposes of determining, among other things, whether a particular instrument constitutes an assignment of a lease or a sale of hydrocarbons, within the meaning of OCSLA and the applicable regulations of the Secretary of the Interior. Under Louisiana law, and thus perforce under federal law, the Ship Shoal transaction cannot be held to constitute a sale of gas. As this Court observed in *Rayne,* Louisiana law does not recognize a sale of gas in place.[28] In this con-

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[26] 43 U.S.C. 1333(a)(1); *infra,* p. 3a.

[27] 43 U.S.C. 1333(a)(2); *infra,* pp. 3a-4a.

[28] 381 U.S. at 400; *infra,* pp. 18b-19b; *Frost-Johnson Lumber Co. v. Salling's Heirs,* 150 La. 756, 91 So. 207: LSA-Rev. Stat. Tit. 9, § 1105 (1962 Cum. Supp.); LSA-Code of Civ. Proc., Art. 3664.

text, the Ship Shoal transaction cannot be construed as a sale of gas (J.A. 78-84).

This conclusion is unaffected by anything in *Rayne* or the Natural Gas Act. In *Rayne,* this Court held that the onshore lease sales there involved "can" be considered sales of gas, rejecting a contention that this result was barred by the law of the State of Louisiana which does not recognize a sale of gas in place.[29] It was persuaded that this is a permissible result under the Natural Gas Act notwithstanding the "technical concepts of local law" (*ibid.*).

But even though elsewhere permissible, Congress decided in OCSLA that such a result cannot be reached on the facts of the *Ship Shoal* case. We are not here concerned with "local" law but with a declaration by Congress as to what shall constitute federal law. The 1953 determination by Congress in OCSLA to make the law of Louisiana the federal law applicable to leases issued under OCSLA was a decision made years after passage of the 1938 Natural Gas Act. As already noted, however, Congress gave certain limited authority to the Commission over pipeline rights-of-way, but none with respect to leases. On the contrary, it expressly provided that mineral leases on the Outer Continental Shelf shall be issued or maintained only under the provisions of OCSLA.[30] It gave the Commission no authority to nullify official acts of the Secretary in discharging his delegated duties.

The court below brushed these considerations aside, holding that there is no conflict between Louisiana law applied through OCSLA, on the one hand, and the

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[29] 381 U.S. at 400.

[30] 43 U.S.C. 1333(a)(1); *infra,* p. 3a.

Natural Gas Act, on the other. Under its view, the law of Louisiana is not applicable since inconsistent with the Natural Gas Act.

This assumes the point at issue. Unlike this Court's holding in *Rayne,* the court below held that these lease sales *must* be considered conventional sales of gas. This needlessly makes the statutes irreconcilable, for it confers power upon the Commission to nullify authority vested exclusively in the Secretary. Such a conflict should and can here be avoided. This Court held that Congress provided for commission jurisdiction over some but not all lease sales and that this jurisdiction "can" be asserted notwithstanding requirements of local law. It did not hold that such jurisdiction *must* be asserted in derogation of another and later federal statute.

Harmony will be assured if the Commission has power to regulate the sale and transportation of gas when produced, recognizing as this Court has held that the gas will not be dedicated to the interstate market before commencement of deliveries, thus preserving the exclusive authority in the Secretary of the Interior over the issuance and maintenance of leases under OCSLA in accordance with the mandate of Congress.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Statutory Provisions Involved

NATURAL GAS ACT

[Act of June 21, 1938, c. 556, 52 Stat. 821, as amended; 15 U.S.C. 717-717w (1964)]

* * * * * * * * * *

Rates and Charges; Schedules; Suspension of New Rates

* * * * * * * * * *

Sec. 4. (c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services. [52 Stat. 822 (1938), as amended, 76 Stat. 72 (1962); 15 U.S.C. § 717c(c) (1964)].

* * * * * * * * * *

Extension of Facilities; Abandonment of Service

* * * * * * * * * *

Sec. 7. (c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That

if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [52 Stat. 825 (1938), as amended, 56 Stat. 83 (1942); 15 U.S.C. § 717f(c) (1964)].

* * * * * * * * * *

OUTER CONTINENTAL SHELF LANDS ACT

[Act of August 7, 1953, 67 Stat. 462;
43 U.S.C. 1331, *et seq.* (1964)]

* * * * * * * * *

Laws and Regulations Governing Lands—Constitution and United States Laws; Laws of Adjacent States; Publication of Projected States lines; Restriction on State taxation and Jurisdiction

Section 4(a)(1)

The Constitution and laws and civil and political jurisdiction of the United States are extended to the subsoil and seabed of the outer Continental Shelf and to all artificial islands and fixed structures which may be erected thereon for the purpose of exploring for, developing, removing, and transporting resources therefrom, to the same extent as if the outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State: *Provided, however,* That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this subchapter.

Section 4(a)(2)

To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State as of August 7, 1953 are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and de-

fining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf. [67 Stat. 462 (1953); 43 U.S.C. 1333(a)(1), (2) (1964)].

* * * * * * * * * * *

Administration of Leasing—Rules and Regulations; Amendment; Cooperation With State Agencies; Violations and Penalties; Compliance with Regulations as Condition of Lease

Section 5(a)(1)

The Secretary shall administer the provisions of this subchapter relating to the leasing of the outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions. The Secretary may at any time prescribe and amend such rules and regulations as he determines to be necessary and proper in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf, and the protection of correlative rights therein, and, notwithstanding any other provisions herein, such rules and regulations shall apply to all operations conducted under a lease issued or maintained under the provisions of this subchapter. In the enforcement of conservation laws, rules, and regulations the Secretary is authorized to cooperate with the conservation agencies of the adjacent States. Without limiting the generality of the foregoing provisions of this section, the rules and regulations prescribed by the Secretary thereunder may provide for the assignment or relinquishment of leases, for the sale of royalty oil and gas accruing or reserved to the United States at not less than market value, and, in the interest of conservation, for unitization, pooling, drilling agreements, suspension of operations or production, reduction of rentals or royalties, compensatory royalty agreements,

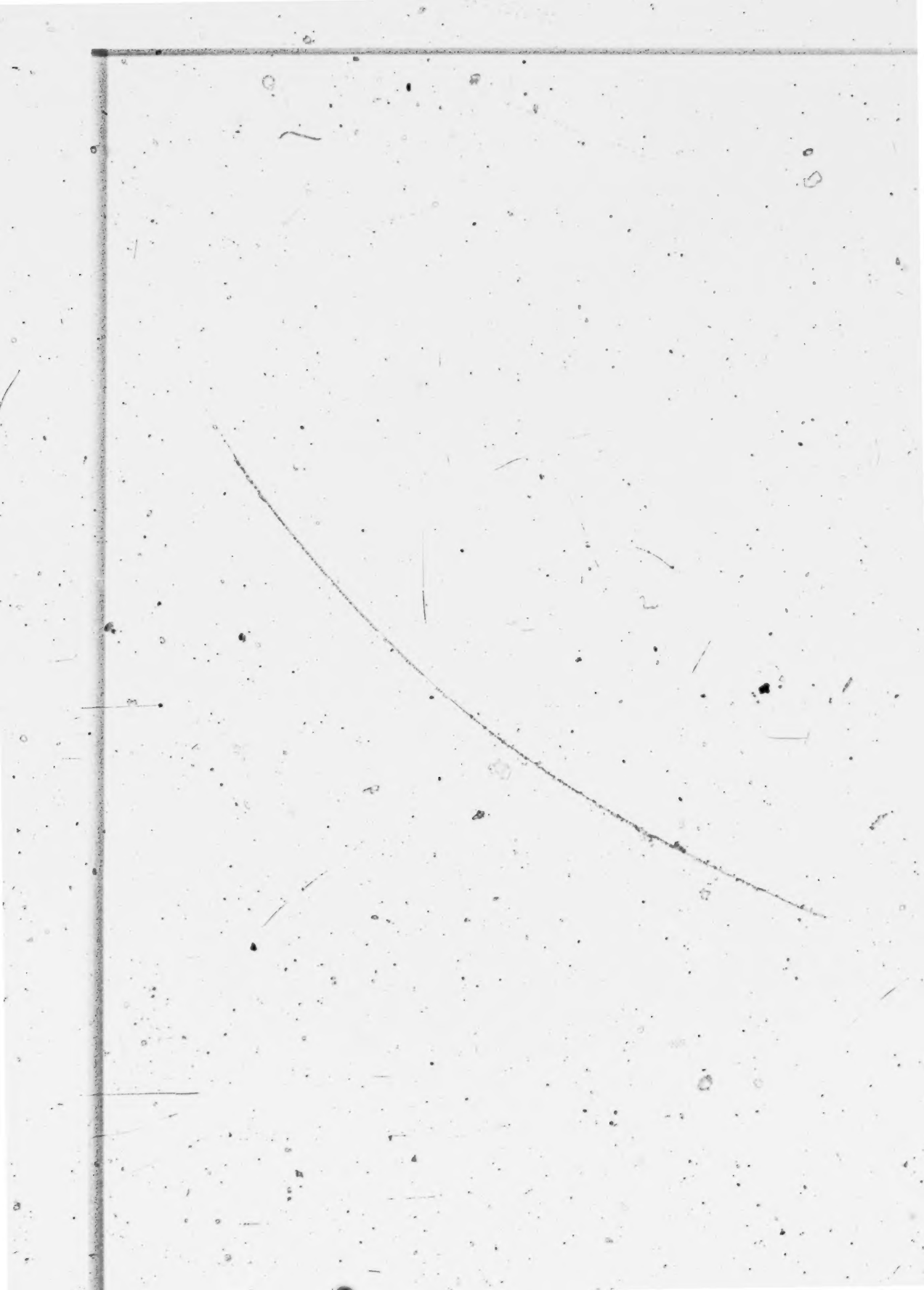
subsurface storage of oil or gas in any of said submerged lands, and drilling or other easements necessary for operations or production.

* * * * * * * * * *

Section 5(c)

Pipeline rights-of-way; forfeiture of grant

Rights-of-way through the submerged lands of the outer Continental Shelf, whether or not such lands are included in a lease maintained or issued pursuant to this subchapter, may be granted by the Secretary for pipeline purposes for the transportation of oil, natural gas, sulphur, or other mineral under such regulations and upon such conditions as to the application therefor and the survey, location and width thereof as may be prescribed by the Secretary, and upon the express condition that such oil or gas pipelines shall transport or purchase without discrimination, oil or natural gas produced from said submerged lands in the vicinity of the pipeline in such proportionate amounts as the Federal Power Commission, in the case of gas, and the Interstate Commerce Commission, in the case of oil, may, after a full hearing with due notice thereof to the interested parties, determine to be reasonable, taking into account, among other things, conservation and the prevention of waste. Failure to comply with the provisions of this section or the regulations and conditions prescribed thereunder shall be ground for forfeiture of the grant in an appropriate judicial proceeding instituted by the United States in any United States district court having jurisdiction under the provisions of section 1333(b) of this title. [67 Stat. 464 (1953); 43 U.S.C. 1334(a)(1), (c) (1964)].



APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22867

TIDEWATER OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22868

THE ATLANTIC REFINING COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22869

CITIES SERVICE OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES).

(December 19, 1966.)

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

WISDOM, Circuit Judge: Petitioners, the four Catco companies, seek review of Federal Power Commission orders. The basic question is whether the petitioners' transfer, in

the form of lease-sale agreements, of certain leasehold interests in the offshore Ship Shoal Field is a sale of natural gas in interstate commerce within the meaning of Section 1(b) of the Natural Gas Act.[1] *United Gas Improvement Co.* v. *Continental Oil Co.*, 1965, 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466 (*Range Field* case), upholding the Commission's ruling that it has jurisdiction over a leasehold purchase arrangement controls this case. We find that the transfer is subject to the Commission's jurisdiction. We affirm the Commission's order requiring certification under Section 7 of the Act.

* * * *

Petitioners, the four Catco companies, have jointly developed leasehold interests in the Ship Shoal area off-shore Louisiana obtained for $11,562,017 from the United States government in 1955 under the Outer Continental Shelf Lands Act. On May 10, 1961, by Acts of Sale and Mortgage and Pledge they conveyed these leaseholds to the Tennessee Gas Supply Company and the Tenneco Oil Company, two subsidiaries of the Tennessee Gas Transmission Company, a major interstate pipeline company.[2] The total

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[1] 15 U.S.C. § 717(b): "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

[2] Negotiations for the Ship Shoal sale had taken place between petitioners and Tennessee Gas Transmission Company. However, the formal instruments effectuating the transaction were executed by Catco and the two subsidiaries of the pipeline, Tennessee Gas Supply Company and Tenneco Oil Company. The gas interests in the leasehold were thereafter assigned to the parent pipeline. This rather complicated arrangement was similar to that employed in the *Rayne Field* transaction; it allowed the parent pipeline company to avoid giving a mortgage on the Ship Shoal properties which would have encumbered its own assets.

consideration was $97,333,333 in cash and notes maturing over 15½ years.

The Commission first considered the Ship Shoal transfer in connection with Tennessee Gas Transmission's 1961 application for certification of an $8.5 million connecting pipeline.[3] Tennessee stated during the course of the proceeding:

> The sole purpose for acquiring the leasehold interests in the Ship Shoal Field was to provide additional reserves and deliverability to meet the natural gas requirements of Tennessee's jurisdictional customers. 30 FPC at 765.

The Catco companies were not parties to the Tennessee proceeding and made no filings with respect to Ship Shoal. The Commission concluded that it could not certify the construction of the pipeline unless it had jurisdiction over the leasehold transfer.[4] Accordingly, the Commission issued the order here on review for petitioners to show cause why their transfer of the Ship Shoal leasehold interests should not be certified under the Act. Tennessee intervened in the resulting FPC hearings and in this appeal. Its application for the Ship Shoal connecting lines has been deferred pending final resolution of the Catco jurisdiction issue now before us.

The examiner found that Catco had drilled seventeen wells in the Ship Shoal Field between acquisition of the

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[3] Tennessee Gas Transmission Co., Opinion No. 403, 30 F.P.C. 759 (1963).

[4] On the basis of the record, the examiner in the *Tennessee* proceeding held that the Ship Shoal transaction involved a sale of natural gas for resale in interstate commerce which was not in the public interest. By Tennessee's own estimates the gas would cost it 28.3 cents per Mcf over a 26 year production period as compared with the area ceiling of 19.5 cents per Mcf. Id., Second Decision of Presiding Examiner, 30 F.P.C. at 801-09, 819-21.

leaseholds in 1955 and May 3, 1960. Seven were completed as oil wells and one as a gas well. The gas well was shut-in and no gas has been produced. The evidence showed seventeen completions in the oil wells and two in the gas well. Gas was found in 46 reservoirs in 39 distinct sand zones and oil in fourteen reservoirs in eight distinct sand zones. In addition, five reservoir sands that produced oil were also productive of gas. Later, drilling on five potential gas wells was commenced but completion was deferred. Production of oil began and the oil was barged inland. The gas well was not hooked up, since Tennessee's application for a pipeline certificate has been deferred.

In 1960 petitioners sought and received several offers for Ship Shoal in the form of both conventional gas purchases and purchases of leasehold interests. Tennessee made offers in both forms. The petitioners chose Tennessee's leasehold purchase offer largely because it produced the greatest discounted net cash flow. Under the Lease Sale Agreement, the four Catco companies each received one-fourth of the total $97⅓ million consideration, $3.1 million in cash and the remainder in notes. The notes are in two series designated "O" and "G", both of them the obligation of Tennessee Gas Supply. One series (the "O" series) is also the obligation of Tenneco, which owns and operates all of Tennessee's domestic oil producing properties. Thus Tenneco's total payment was $12 million ($387,500 cash and remainder in "O" series notes); Gas Supply's was $85⅓ million ($2,712,500 cash and remainder in "G" series notes). The buyers and sellers agreed for purposes of establishing the rights of the parties, that the total quantity of *recoverable reserves* of gas attributable to the leasehold interests was 533,333,333 Mcf and the total quantity of recoverable oil 12,244,898 barrels. This stipulation was partly for the purpose of establishing security. These figures were also used to arrive at comparison levels and unit prices for the redetermination provisions of the agreements. The redetermination provisions, common in

leasehold sales, provide for recomputation of the total price, at the request of any party, during the seventh year following the signing of the agreements. In such event, the recoverable quantities of oil and gas would be redetermined by arbitration proceedings. And the amounts by which the estimates of recoverable reserves were changed above or below 533,333,333 Mcf of gas and 12,244,898 barrels of oil would result in an adjustment in the total purchase price of 16 cents per Mcf (85⅓ million/533,333,333) and 98 cents per barrel ($12 million/12,244,898) above or below those base quantities. The examiner credited testimony that the base quantities represented only an arbitrary present determination of reserves arrived at by negotiation. They are not the average of actual engineering estimates obtained by parties to the transaction. Indeed the figure agreed upon is lower than any actual estimate mentioned in the hearings.

The Ship Shoal lease sale transferred to Tennessee's subsidiaries all mineral rights down to the base of the MI sand, including rights to produce and sell oil, casinghead gas, gas, condensate, and natural gas liquids, as well as related equipment. The Catco companies retained no responsibility for the management or operation of the interests. However, Tennessee was given the option to require petitioners to purchase all the crude oil to be produced from the properties at the average price posted in nine South Louisiana fields. Tennessee insisted on the oil purchase provision to assure a market for the oil, since Tennessee itself is not in the oil business. This option has been continuously exercised since 1962. The note installments are being paid on schedule.

The examiner found that the Ship Shoal transaction, therefore, was a "sale of natural gas for ultimate public consumption within the meaning of the Natural Gas Act.": "This record shows the transfer of a vast reserve of natural gas, located outside the boundaries of any State, into

the hands of a pipeline company whose business is the transportation and sale of natural gas within the United States. * * *" But the examiner concluded that the Commission lacked jurisdiction because of this court's opinion in the *Rayne Field* case[5] that leasehold transactions generally were exempt under Section 1(b) exempting "the production and gathering of natural gas. The Commission adopted the examiner's findings except for his conclusion, which it reversed pending review of the *Rayne Field* case in the Supreme Court. The Supreme Court's *Rayne* decision in favor of jurisdiction came six months later. Thus, the Commission findings before us in Ship Shoal do not reflect the Court's *Rayne* opinion. However, they do provide a sufficient basis for our application of the standards the Court announced in that case.

The Commission order under review directs the petitioners to file, within six months, appropriate rate schedules and applications for certificates and to take other steps necessary to bring the Ship Shoal transfer within the requirements of the Act.[6] However, it should be noted that no questions are before us relating to the propriety of the Commission's disposition of the case following its assertion of jurisdiction. Before us is only the jurisdictional question. Compare *Rayne, supra,* 381 U.S. at 399.

The petitioners concede that there is no dispute regarding the relevant facts. However, they contend that the Commission made a number of ultimate findings not supported by substantial evidence.

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[5] Marr v. Federal Power Comm'n, 5 Cir. 1964, 336 F.2d 320, rev'd sub nom. United Gas Improvement Co. v. Continental Oil Co., 1965, 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466. See 44 Texas L. Rev. 356 (1965).

[6] The Catco Companies filed petitions for review and stay of the orders in the Fifth, Ninth, Tenth and District of Columbia circuits. These orders were granted, and review proceedings were consolidated in this court for all petitioners.

I.

The *Rayne Field* case is the most recent link in the chain of Supreme Court decisions defining the Commission's jurisdiction over wellhead sales by independent producers. The chain began, of course, with *Phillips Petroleum Co.* v. *Wisconsin,* 1954, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035. Since the *Catco* case (*Atlantic Refining Co.* v. *Public Service Commission of New York,* 1959, 360 U.S. 378, 79 S.Ct. 1246, 3 L.Ed.2d 1312), the Commission has attempted to hold producers to prices "in line" with similar sales. But until *Rayne* one class of gas transfer had eluded the Commission's jurisdiction: the transfer of leasehold interests in developed fields. The obstacle to Commission regulation of these leasehold transfers was *Federal Power Commission* v. *Panhandle Eastern Pipeline Co.,* 1949, 337 U.S. 498, 69 S.Ct. 1251, 93 L.Ed. 1499. In that case the Court stated flatly, "Of course leases are an essential part of production", 337 U.S. at 505, 93 L.Ed. at 1505, and therefore fall under the Section 1(b) "production and gathering" exemption.

In *Rayne* the Court construed the "production and gathering" exemption as applicable to "state regulatory power over by physical processes of production or gathering in furtherance of conservation or other legitimate state concerns", but not to sales of the kind "affirmatively subjected" to Commission jurisdiction. 381 U.S. at 403. In effect, the Court broke down the sharp distinction between the conventional sale of wellhead gas and the sale of leasehold interests that had prevailed since *Panhandle.* Under *Rayne,* the lease transfer is no longer to be arbitrarily excluded, purely as a matter of form, from Commission jurisdiction. The test is not whether the transaction in question is in form a lease-sale or a sale of gas. The transaction may be a lease-sale in accordance with local law and a sale of gas under the Act. "Without impugning in any way the good faith and genuineness of the transac-

tions, we think it clear that the lease-sales here in question can nonetheless be considered 'sales' of natural gas in interstate commerce for purposes of the Act." 381 U.S. at 400. The Court directed a case-by-case analysis of the substance of each transfer. The test is three-pronged:

> (1) Is the economic effect of the transfer similar to that of a conventional sale?
>
> (2) Is the subject of the transaction "proven and substantially developed" reserves?
>
> (3) Is the transfer of the reserves for purpose of interstate transmission and resale?

The Court made it clear that the economic effect on the parties could deviate somewhat from conventional sales. The fundamental inquiry is whether "the sales of these leases in . . . a proven and substantially developed field . . . accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other *States. That is the significant and determinative economic fact.*" (Emphasis added.) 381 U.S. at 401. Employing this case-by-case approach, the Court distinguished *Panhandle,* where the leases were undeveloped and the sale was in *intra*state commerce. In a summary opinion based on *Rayne* the Court has also affirmed Commission jurisdiction over transfer of the Bastian Bay Field leases. *Federal Power Commission* v. *Pan. American Petroleum Corp.,* 1965, 381 U.S. 762, 85 S.Ct. 1802, 14 L.Ed.2d 714, rev'g 10 Cir. 1964, 339 F.2d 694, rev'g 30 F.P.C. 1477 (1963).

II.

The petitioners contend that the Ship Shoal transaction is sufficiently different in economic effect from *Rayne* to preclude its characterization as a jurisdictional sale.

A. The Ship Shoal assignment they contend, was not a substitute for a conventional sale of gas, as the lease trans-

fer was in *Rayne*. In *Rayne* the sellers first executed conventional sales contracts, but later withdrew their application for certification when it appeared that, because of the *Catco* case,[7] the Commission might not approve the application. Here the petitioners requested several prospective purchasers to make an offer for the leases and, alternatively, an offer for a conventional purchase of gas. The plan was to obtain "a basis for economic comparison" between the two different types of sales. Present value was the common denominator. The chief objective was the highest possible discounted net cash flow. Analysis showed that the discounted net cash flow for a Catco company from 22 years of continuous operations would be $7,449,000; but that from a lease sale to Tennessee it would be $8,598,000 payable in only 16 years. We do not find this a significant difference between the two plans. The Supreme Court had the same distinction open to it in *Rayne*, which also involved a 16-year note repayment plan. The difference in economic effect between the two figures of net cash flow is principally that between similar earnings discounted over 16 years and 22 years. It goes more to the method of payment than to the substantial economic effect of the transfer.

B. The Ship Shoal assignment, petitioners argue, is distinguished from the *Rayne* transaction by the transfer of all mineral interests and control to the buyer. In *Rayne*, the Court noted that the lease-sales were to cover no minerals except natural gas and condensate, all other mineral rights being reserved to the lease-sellers. By a management agreement one of the sellers was to continue the bulk of production work. The Ship Shoal lease agreement, however, transferred all the leasehold interests including the

[7] Public Serv. Comm'n of New York v. Federal Power Comm'n, 3 Cir. 1958, 257 F.2d 717, *aff'd sub nom.* Atlantic Refining Co. v. Public Service Comm'n of New York, 1959, 360 U.S. 378, 79 S.Ct. 1246, 3 L.Ed.2d 1312.

right to produce and sell oil, casinghead, condensate, and natural gas liquids. The petitioners retained no role in the control or management of the properties conveyed. But these differences between the two transactions are blurred by related similarities. Although the Ship Shoal agreement transferred both gas and oil rights, Tennessee has repeatedly sought to purchase the oil leaseholds if the Catco companies would continue to develop and operate them or, alternatively, that Tennessee would take back the oil extracted by Tennessee at a mutually agreeable shore point. In the final agreement the petitioners gave Tennessee the option to require Catco to purchase crude oil produced from the properties at the average posted price. As stated by one witness for Catco, "Tennessee was not in the oil business although it was affiliated with a company [Tenneco] that was. Tennessee insisted on assurance that it would have a market for the crude and receive for it the price current at the time of production."[8] In exercise of the option Tennessee has sold back to Catco virtually all oil taken from Ship Shoal. This may not be a "wash sale" in the usual sense, but it is clear that Catco's obligation to repurchase the crude oil represents a significant retained interest in Ship Shoal. The petitioners assumed the functions and risks of refining and marketing the Ship Shoal oil.

Similarly, the differences in control and management between the *Rayne* and Ship Shoal arrangements is not substantial enough to defeat jurisdiction. The buyer in *Rayne,* even though without operational responsibility, still enjoyed the right to make major production decisions such

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[8] The Crude Oil Purchase recited:

"*A principal condition of Seller and moving consideration to Seller* in entering into such lease acquisition transaction is this agreement on the part of Buyer to purchase the quantities of crude oil produced from said leases which Seller hereby is granted the right to sell to Buyer and Buyer hereby agrees to purchase." (Emphasis added.)

as determining the volume of gas to nominate for production each month and whether new wells should be drilled.[9] In Ship Shoal, the buyer takes the operational responsibility along with the important policy decisions. Ship Shoal in this respect is similar to the *Bastian Bay* transaction over which the Court affirmed FPC jurisdiction. Tennessee in that case also was to operate and to complete development of the field.[10]

C. Indeed we perceive numerous identities between Ship Shoal and the two lease-sale transactions ruled on by the Supreme Court. The payment for the Ship Shoal leases, as in *Rayne,* is represented by notes spread over a 16-year period, and the notes have an acceleration clause geared to production, apparently as a security device. And an intermediate corporate structure shields the pipeline company from principal obligation on the notes to the producers. And as in *Bastian Bay,* the Ship Shoal agreement provides for a redetermination of the gas reserves at a future period.

We conclude that here, as in *Rayne* and *Bastian Bay,* the economic effect of the transfer does not differ enough from a conventional sale to defeat Commission jurisdiction.

III.

The petitioners contend that the Ship Shoal gas reserves do not meet *Rayne's* "proven and substantially developed" test. There was little question on appeal that *Rayne* was a proven and substantially developed field. Thus the Court felt no need to spell out this standard in that case. It justified the test with this rationale:

> "The substantiality of development is a relevant consideration, for the more that must be done before the

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[9] 381 U.S. at 396 & n. 4, 85 S.Ct. at 1520, 14 L.Ed.2d at 469.

[10] 30 F.P.C. at 1482, 1490, 1504.

gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce. . . ."[11]

The Supreme Court did not say that such proof of substantiality is the only consideration. Starting with that rationale, however, we conceive the applicable standard to be as follows: Have the leaseholds been sufficiently proved and developed for imminent production of natural gas in commercial quantities? Two criteria emerge from this standard. One is definability of gas volume based upon proof of reserves; the other is imminent ability to produce in commercial quantities. The Commission did not direct its findings expressly to these issues since, as we have noted, its opinion preceded that in *Rayne*. However, the Commission did make numerous findings, supported by substantial evidence and elaborated in its brief, to justify our holding that the Ship Shoal leaseholds were "proven and substantially developed."

Tested under the "proven and substantially developed" criteria, as we conceive them, both *Rayne* and *Bastian Bay* fields deserve a high rating. In *Rayne Field*, 19 wells were in the ground, and 7 more were to be drilled.[12] Natural gas would and did begin to flow in commercial quantities into the buyer's system immediately upon completion of

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[11] 381 U.S. at 403, 85 S.Ct. at 1524, 14 L.Ed.2d at 474.

[12] 381 U.S. at 396 & n. 3, 85 S.Ct. at 1520, 14 L.Ed.2d at 469. The Court and opinions below did not state whether all of these were gas wells, but we will assume they were. Nor do the opinions state whether these wells were drilled at the time of the sale or not until the 1963 show cause hearing. Texas Eastern Transmission Corp., Opinion No. 378, 29 F.P.C. 249, 264-65 (1963).

its connection with the field.[13] Although there was controversy at the hearing level over the extent of the Rayne reserves, the Commission found them to be of "substantial size." Total estimated recoverable reserves were about 990,000 Mmcf.[14] There was further evidence of possible additional reserves in the Rayne untested sands. The Commission considered Rayne a "fully developed" field.[15] The situation was similar at *Bastian Bay*. The seller had drilled 32 wells and achieved 21 oil completions and 20 gas completions. The field had fifteen gas wells and five oil and gas wells, either wholly or partially subject to the transferred leases, which were promptly connected to the buyer's collection system.[16] Commercial quantities of natural gas began to flow into buyer's lines at the time of the connection.[17] The parties stipulated in the lease sale agreement that recoverable reserves of gas transferred were

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[13] Texas Eastern constructed and connected its facilities to *Rayne Field* in the time between a Commission certification order and its reversal by the District of Columbia Court of Appeals. Between the date the facilities were placed in operation and January 1, 1961 (less than a year), Texas Eastern took approximately 65,000 Mcf of natural gas from Rayne Field into its interstate system. See Texas Eastern Transmission Corp., *supra*, Note 12 at 264.

[14] Texas Eastern Transmission Corp., Opinion No. 378, 29 F.P.C. at 251 (1963).

[15] Texas Eastern Transmission Corp. (G-12446), 21 F.P.C. 860, 861 (1959).

[16] Tennessee Gas Transmission Co., Opinion No. 413, 30 F.P.C. 1477, 1493 (1963).

[17] Tennessee installed a 2.63 mile line to Bastian Bay under a budget-type authorization before the Commission asserted jurisdiction over the lease-sale. At the time of the hearing for a regular § 7 authorization, production from Tennessee's Bastian Bay reserves was about 40,000-50,000 Mcf per day; this was about 1⅓ years after Tennessee connected its line to the field. Tennessee Gas Transmission Co., Opinion No. 413, 30 F.P.C. 1477, 1479, 1502 (1963).

759,350,000 Mcf. Although the buyer in *Bastian Bay,* also Tennessee, was able to complete the development of the field, there apparently was no controversy that it was extensively developed at the time of the sale.[18]

Ship Shoal obviously was not as extensively developed as were *Rayne* and *Bastian Bay Fields;* it had only one gas well compared with nineteen and fifteen respectively in the other two fields. But "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation". *Phillips,* 347 U.S. at 402. We conclude that Ship Shoal had reached the stage of proof and development necessary to satisfy the *Rayne* criteria.

A. Tennessee's faith in the amount of Ship Shoal reserves destined for interstate consumption indicates that the field had at least been developed to the point where a reasonable estimate could be made as to the available reserves. Ship Shoal was a bargained transaction among corporations with vast experience, not only in the petroleum business, but also in the Louisiana fields. The prospective buyer, Tennessee, as might be expected, asserted throughout the negotiations the lowest estimate of net recoverable reserves. Tennessee's estimate was 530,000 Mmcf. The prospective sellers' estimates ranged from about 730,000 to 823,000 Mmcf. Even at the time of closing, there remained a wide variance in reserve estimates among the parties for the purpose of setting the total price. In the end, however, Tennessee was willing to invest over $97 million on its faith in the lowest of the reserve estimates, 530,000 Mmcf., subject to a redetermination provision similar to that used in *Bastian Bay.* And Tennessee applied forthwith to the Commission for transmission certificates based on an estimate of 533,402,000 Mcf in available reserves.[19]

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[18] See *Id.* at 1504.

[19] Tennessee Gas Transmission Co., Opinion No. 403, 30 F.P.C. 759, 762 (1963).

We recognize that estimates of reserves in Ship Shoal may vary considerably until the field is fully drilled and there is productive history over a period of years under operating conditions. But Catco has conceded that a definite and definable volume of gas cannot be determined down to the last cubic foot even after a well has been fully depleted. One can make only estimates of gas. There are some producing areas where it is possible to estimate recoverable reserves with a high degree of accuracy although the particular leases are undrilled and undeveloped. In offshore fields and in South Louisiana, however, reserve estimates are more difficult to determine even after full development because of multiple formations and faulted reservoirs. The effect of redetermination provision is to negate or to diminish substantially the shifting of the risk relating to gas deliverability from the petitioners to Tennessee. We conclude that the recoverable reserves in Ship Shoal field were sufficiently definable to satisfy the *Rayne-Bastian Bay* requirement of proof. The Commission's findings in this regard are supported by substantial evidence.

B. Similarly, Tennessee's readiness to connect its lines to Ship Shoal is a strong indication that the field was "substantially developed" at the time of transfer. Tennessee relied heavily on the Ship Shoal reserves in support of its 1960-62 applications for expanded pipeline facilities.[20] It was aware that in comparable situations the Commission generally grants authorization on the condition facilities will be constructed and placed in actual operation within one year of certification.[21] Tennessee estimated that its Ship Shoal operations could begin in 1963, with first-year gas operating and maintenance expense of $853,400 (no well-workover expense) and similar expense of over $1.3

[20] *Id.* at 765.

[21] *Id.* at 770. See F.P.C. Reg. § 157.20(b), as amended (1957).

million per year for the next 16 years.[22] The presiding examiner in the 1963 *Tennessee* proceeding concluded that the Ship Shoal gas had been "ready for action since 1960, can be and should be connected without further delay," but for the unresolved *Catco* jurisdictional question and related procedural issues. He agreed that the Ship Shoal gas, the "adequacy of its reserves *and deliverability,*" was essential to support Tennessee's 1960-62 applications for increased service.[23]

The Catco witnesses in the present proceeding did not refute the evidence of Ship Shoal's imminent ability to produce gas in commercial quantities. *Cf. Continental Oil Company* v. *Federal Power Commission*, 5 Cir. 1957, 247 F.2d 904, 907. It appears that two completions in one gas well could have been piped up and produced immediately, although the five deferred wells would need further development by Tennessee. Catco conceded that it could have taken certain steps leading to the production of one or more of the wells. Further a Catco expert estimated that once production began, as much as 10 per cent of the reserves could be extracted in less than four years.

It may well be that Ship Shoal is a "long way" from being fully developed. Catco anticipated that from 34 to 40 additional completions would be necessary to calculate the final consideration in the seventh year redetermination of reserves. But this problem relates more to determination of final consideration, than to imminent ability for production. The "substantial and determinative economic fact" is that Catco transferred a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission. The Commission's findings, sup-

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[22] Tennessee Gas Transmission Co., *supra* note 19, Second Initial Decision of Presiding Examiner, 30 F.P.C. at 803.

[23] *Id.* at 798.

ported by substantial evidence, lead us to the conclusion that Ship Shoal was "proven and substantially developed" under the standards of *Rayne* and *Bastian Bay*.

IV.

We see no merit in petitioners' contention that the Ship Shoal transfer was not a sale in interstate commerce.[24] Tennessee, an intervenor in these proceedings, has shown an unequivocal intention to connect Ship Shoal to its interstate transmission system. Its application to expend $8.5 million for a connecting line remains pending; it was deferred only until settlement of the Commission's jurisdiction over the underlying transfer. Moreover, the Ship Shoal field *is located outside the borders of any state and any gas taken will have to be transported across state lines for sale* within the United States. The petitioners do not deny the truth of these jurisdictional facts, and they have not offered any evidence to show that the Ship Shoal gas is not destined for ultimate public consumption in other states when Tennessee completes its planned transmission facilities. See *Continental Oil Co.* v. *Federal Power Comm'n*, 5 Cir. 1957, 247 F.2d 904, 907.

The petitioners contend also that Tennessee remained free even to reject a proffered certificate to connect with its $85⅓ million Ship Shoal reserves. But the Commission cannot decline jurisdiction of a gas sale on the mere possibility that the buyer may eventually reject Commission authorization of the connecting line. Tennessee has already paid millions of dollars for the leasehold, is con-

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[24] Section 2(7) of the Natural Gas Act, 15 U.S.C. § 717a(7), defines interstate commerce as follows:

> "'Interstate commerce' means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place thereof, but only insofar as such commerce takes place within the United States."

tinuing to make regular payments toward the total price of $85 million, and its application to transport Ship Shoal gas in interstate commerce is pending. Similarly, the Commission cannot abstain from exercising jurisdiction of petitioners' sales on that basis. See *Atlantic Refining Co.* v. *Public Service Comm'n of New York,* 1959, 360 U.S. 378, 387, 79 S.Ct. 1246, 3 L.Ed.2d 1312, 1318.

The Ship Shoal transaction may be distinguished from *Panhandle* in the same way as *Rayne:* The Ship Shoal leases were developed and the sale of the natural gas was in interstate commerce.

V.

Petitioners further assert that the Outer Continental Shelf Lands Act of 1953 [25] (OCSLA) precludes classification of the Ship Shoal transfer as a Gas Act sale. The Ship Shoal leases, unlike those in *Rayne* and *Bastian Bay,* were originally granted by the United States through the Department of the Interior under the OCSLA. Section 4(a)(1) of the OCSLA provides that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this Act." [26] And Section 4(a)(2) makes the laws of the adjacent state (here Louisiana) federal law for the outer Continental Shelf " to the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary [of Interior]." [27] As petitioners read these provisions, Louisiana law determines, as a matter of federal law, whether a particular instrument constitutes an assignment of a lease or a sale of hydrocarbons. The catch is that Louisiana does not recognize a sale of gas in place. *Frost Johnson Lumber Co.* v. *Salling's Heirs,* 1923, 150 La.

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[25] 43 U.S.C. §§ 1331-1343.

[26] 67 Stat. 462 (1953), 43 U.S.C. § 1333(a)(1).

[27] 67 Stat. 462 (1953), 43 U.S.C. § 1333(a)(2).

756, 91 So. 207; La. Rev. Stat. Tit. 9, § 1105; La. Code of Civ. Proc., Art. 3664. This feature of Louisiana law did not frustrate the Supreme Court in *Rayne*. Presented with a conflict between federal and state law, the Court refused to allow the Gas Act to be "hamstrung" by "technical concepts of local law." 381 U.S. at 400 & n. 7, 85 S.Ct. at 1522, 14 L.Ed.2d at 472.

In this case the petitioners frame the conflict as one between two federal statutes—the Gas Act on the one hand and Louisiana law applied through the OCSLA on the other. This view of the OCSLA overlooks the express statutory exception to application of state law. Louisiana laws would apply under OCSLA § 4(a)(2) only "to the extent . . . *not inconsistent with* . . . other Federal laws." The Supreme Court has already held in *Rayne* that Louisiana's failure to recognize the sale of gas in place is inconsistent with application of the Gas Act. Louisiana's characterization of the Ship Shoal transaction, to the extent it conflicts with the Gas Act definition of the transaction, is inapplicable.

This result is fully consistent with the respective purposes of the OCSLA and the Gas Act. Congress passed the OCSLA solely to regulate the "leasing and development * * * of the oil potential of the Continental Shelf." H.R. Rep. No. 413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad. News 2178 (1953). The OCSLA makes no provision for the regulation of gas sales of independent producers.[28] In contrast, "protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act," *Phillips Petroleum Co.* v. *Wisconsin, supra,* 347 U.S. at 685. The "congressional intent [was] to give the Com-

[28] The *Phillips* decision in 1954, extending FPC jurisdiction to independent producer sales, did not come until one year after passage of the OCSLA.

mission jurisdiction over the rates of all wholesales of natural gas in interstate commerce." Id. at 682. The plain meaning and legislative history of the statutes show, at least in this case, that the OCSLA and the Gas Act must be applied reciprocally in furtherance of their individual regulatory purposes.

* * * *

The crucial fact here, as in *Rayne,* is that the assignment of the leases accomplished the transfer of large amounts of substantially proven off-shore natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production—even if there has also been a transfer of an interest in real property. If such sales were not subject to Commission regulation, an "attractive gap" in the regulatory system would be created, and the producing states would be unable to close it. *California* v. *LoVaca,* 1964, 379 U.S. 366, 369-71, 85 S.Ct. 486, 13 L.Ed.2d 357. Since only the jurisdictional issue is before us in this proceeding, we simply affirm the Commission's order directing the petitioners to make filings and take other steps necessary to comply with the provisions of the Natural Gas Act.

The order is AFFIRMED.

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22867

TIDEWATER OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22868

THE ATLANTIC REFINING COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22869

CITIES SERVICE OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES.)

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

Judgment

This cause came to be heard on the petitions of Continental Oil Company, Tidewater Oil Company, The Atlantic Refining Company, and Cities Service Oil Company, for

review of Orders of the Federal Power Commission issued on October 23, 1964 and December 21, 1964, in Docket Nos. RI64-129, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the Orders of the Federal Power Commission in these causes be, and the same are hereby, affirmed.

December 19, 1966

Issued as Mandate:

[Filed, January 27, 1967]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22867

TIDEWATER OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22868

THE ATLANTIC REFINING COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22869

CITIES SERVICE OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES).

(Jan. 27, 1967)

On Petition for Rehearing

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause is hereby DENIED.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	6
Conclusion	10

CITATIONS

Cases:

Columbia Gulf Transmission Co., 30 F.P.C. 831	6, 7
Federal Power Commission v. *Pan American Petroleum Corporation*, 301 U.S. 762	6, 7, 10
Tennessee Gas Transmission Co., 30 F.P.C. 759	4, 5, 8
Tennessee Gas Transmission Co., 29 F.P.C. 4	6
United Gas Improvement Co. v. *Continental Oil Co.*, 381 U.S. 392	5-8, 10

Statutes and Regulations:

Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717w:	
Section 1(b), 15 U.S.C. 717(b)	2
Section 7(c), 15 U.S.C. 717f(c)	9
Outer Continental Shelf Lands Act, Aug. 7, 1953, 67 Stat. 462, 43 U.S.C. 1331, *et seq.*	8
Section 4(a)(1), 43 U.S.C. 1333 (a)(1)	8
Section 4(a)(2), 43 U.S.C. 1333 (a)(2)	8
Statement of General Policy No. 61-1, 24 F.P.C. 818, 18 C.F.R. 2.56, Fourth Amendment, 26 F.P.C. 661	4

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1323

CONTINENTAL OIL COMPANY, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B, 1b-20b) is reported at 370 F. 2d 57. The opinion of the Federal Power Commission (J.A. 641-645) is reported at 32 F.P.C. 1167, and its order denying rehearing (J.A. 645-649) at 32 F.P.C. 1487.

JURISDICTION

The judgment of the court of appeals (Pet. App. B, 21b-22b) was entered on December 19, 1966, and the

order denying rehearing (Pet. App. B, 23b) on January 27, 1967. The petition for a writ of certiorari was filed on April 25, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r (b).

QUESTION PRESENTED

Whether the Commission properly treated certain transfers of gas leases as sales of natural gas subject to its regulatory jurisdiction.

STATUTES INVOLVED

Section 1(b) of the Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821, 15 U.S.C. 717(b), provides as follows:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The other pertinent statutory provisions are printed in Pet. App. A, 1a-5a.

STATEMENT

1. Petitioners (four producers of oil and natural gas who are referred to collectively as the "Catco"

group) obtained from the United States leases to explore for oil and gas in 10,000 acres in the "Ship Shoal" area off the Louisiana shore (Pet. 3, J.A. 90-121). Petitioners drilled 17 wells under these leases, resulting in 17 oil completions in 7 wells and 2 gas completions in one well. Gas was found in 46 reservoirs in 39 distinct sand zones, oil in 14 reservoirs in 8 distinct sand zones. (J.A. 3-5, 120, 121.)[1]

Petitioners then sold rights to produce oil and gas in an area comprising about 35 percent of the leasehold to two subsidiaries of Tennessee Gas Transmission Company[2] (J.A. 239-241, 307), this being the area believed to contain productive reservoirs (J.A. 31-32). The contract stated that the net recoverable reserves being transferred amounted to 533,333,333 Mcf of natural gas and 12,244,898 barrels of oil (J.A. 257).[3] Tennessee also acquired wells and equipment and the right to condensate and casinghead gas (J.A. 30), and an option, which it has exercised, to sell the oil produced from the leasehold to petitioners (J.A. 60, 580). In return, it agreed to pay petitioners $97,333,333, partly in cash and partly in notes that bore no interest (save in case of default) and were subject

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[1] Five reservoir sands that produced oil were also productive of gas (J.A. 25). Drilling on five potential gas wells was also begun but then was suspended "until some later date" (J.A. 5, 7).

[2] The purchasers are hereinafter referred to as "Tennessee".

[3] Provision was made for a redetermination of the reserves in the seventh year with a price adjustment upward or downward depending on whether they were found to exceed or to fall short of the estimated amounts (J.A. 257-258, 266-267). However, the price may not be reduced below $25 million (J.A. 273).

to accelerated payment should production of gas exceed specified quantities (J.A. 24, 35, 122-123, 252-259, 274). No gas is yet flowing from the transferred reserves (J.A. 46). The note installments continue to be paid (J.A. 47).

2. Tennessee applied to the Federal Power Commission for a certificate of convenience and necessity authorizing enlargement of its pipeline facilities to enable it to take and transmit the gas involved in the transaction. *Tennessee Gas Transmission Co.*, 30 F.P.C. 759, 762. During the course of this proceeding, Tennessee stated (30 F.P.C. at 765):

> The sole purpose for acquiring the leasehold interests in the Ship Shoal Field was to provide additional reserves and deliverability to meet the natural gas requirements of Tennessee's jurisdictional customers.

The examiner held that the Ship Shoal transaction with petitioners was a sale of natural gas to Tennessee in interstate commerce for resale, and hence "jurisdictional" (*i.e.*, subject to the Federal Power Commission's jurisdiction), and, on the merits, that the sale was not in the public interest because, *inter alia*, the gas would cost 28.3 cents per Mcf, far above the area ceiling[4] of 19.5 cents (30 F.P.C. at 801-809,

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[4] The "area ceiling" is the rate for an area fixed by the Commission, pending the outcome of area rate proceedings, to serve as a guide "in determining whether proposed initial rates [of independent producers] should be certificated without a price condition and whether proposed rate changes should be accepted or suspended." Statement of General Policy No. 61-1, 24 F.P.C. 818, 18 C.F.R. 2.56; Fourth Amendment, 26 F.P.C. 661.

819-821). On review of the examiner's decision, the Commission, while expressing agreement that the transaction was a jurisdictional sale, held that Tennessee's application should not be decided until a record could be made with respect to the jurisdictional question (as well as the public-interest question) in a proceeding in which the producers would be parties (30 F.P.C. at 764-767). Accordingly, the Commission issued an order to petitioners to show cause why they should not be found to be engaged in the jurisdictional sale of natural gas from the Ship Shoal field to Tennessee (J.A. 614-616; 30 F.P.C. 758), meanwhile deferring decision on Tennessee's application (30 F.P.C. at 767, 769).

3. After hearings in the show-cause proceeding, the Commission found that the Ship Shoal sale was jurisdictional and allowed petitioners an opportunity to make the necessary filings to bring them into compliance with the Natural Gas Act (J.A. 644, 648). The court of appeals affirmed this determination on the basis of this Court's *Rayne Field* opinion (*United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392).[5] It ruled that the Commission's findings, supported by substantial evidence, justified a conclusion that the Ship Shoal leaseholds were proven and substantially developed and hence that the transfer of those leaseholds constituted a sale under the Natural Gas Act (Pet. App. 12b, 15b, 16b-17b). The court stressed that (Pet. App. 16b-17b)

[5] This Court's *Rayne Field* decision was subsequent to the Commission's decision in the instant case but of course preceded the court of appeals' decision on review.

> Catco transferred a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission. The Commission's findings, supported by substantial evidence, lead us to the conclusion that Ship Shoal was 'proven and substantially developed' under the standards of *Rayne* and *Bastian Bay*.[6]

The court found no conflict between the Outer Continental Shelf Lands Act of 1953 (OCSLA), 43 U.S.C. 1331-1343 (Pet. App B, 3a-5a), governing the development of offshore resources, and the Natural Gas Act. It rejected petitioners' argument that OCSLA repealed the Gas Act in favor of Louisiana State law (which does not recognize a sale of gas in place), noting that OCSLA adopts State law only if "not inconsistent * * * with other Federal laws" (Pet. App. 18b).

ARGUMENT

In the *Rayne Field* case (*United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392), this Court held that sales of leasehold interests which resulted in the transfer of large amounts of natural gas to an interstate pipeline for resale in other States were properly treated by the Commission as jurisdictional sales of natural gas. In the present case,[7] the court

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[6] *Bastian Bay (Federal Power Commission* v. *Pan American Petroleum Corp.*, 381 U.S. 762) was a companion case to *Rayne Field*, that this Court decided in a *per curiam* order in reliance on its *Rayne Field* opinion.

[7] The case at bar is the last of five major efforts to avoid regulation by the Commission by the device of a sale of lease-

of appeals concluded (Pet. App. 12b-17b, 20b) that the sale of the Ship Shoal leaseholds was an essentially similar transaction.[8] The court emphasized that the economic effect of the Ship Shoal sale was not materially different from that of a conventional sale of gas (Pet. App. 11b) and that Tennessee's intention to connect the Ship Shoal reserves to its interstate transmission system demonstrated that the sale was in interstate commerce (Pet. App. 17b-18b).

Petitioners, pointing to this Court's observation in the *Rayne Field* case (381 U.S. at 403) that the degree of development is a relevant consideration in determining whether sale of a leasehold interest involves

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hold interests, the others being *Rayne Field* and *Bastian Bay, supra*, and *MCN* and *King Ranch*. In *MCN*, the examiner denied the purchaser's application for a certificate authorizing the necessary taking facilities, and the parties then entered into a conventional sale of gas. *Tennessee Gas Transmission Co.*, 29 F.P.C. 4. In *King Ranch*, the sequence was the same: denial of a certificate by the examiner (*Columbia Gulf Transmission Co.*, 30 F.P.C. 831) followed by substitution of a conventional sale of gas (see *ibid.*). The producers in *Rayne Field* have now filed an application for a certificate of public convenience and necessity authorizing the sale of the leaseholds to Texas Eastern Transmission Corporation, the original purchaser. The Commission has not yet acted on the application.

[8] The court noted a number of specific respects in which the Ship Shoal transactions resembled those in *Rayne Field* and *Bastian Bay*: notes payable over 16 years, with an acceleration clause geared to production; intermediate corporate structures to shield the pipeline companies from principal obligation on the notes; and provision for future redetermination of the gas reserves and corresponding price revisions (Pet. App. 11b). All these factors indicate, of course, that the pipeline purchaser was not really assuming the risks of production; that, realistically viewed, it was purchasing gas.

a jurisdictional sale of gas, argue that development of the Ship Shoal field was not sufficiently substantial for this purpose. This essentially factual issue does not merit further review. The court below did not hold that every sale of a leasehold is a jurisdictional gas sale. Rather, it carefully examined the circumstances of the particular transaction—noting especially the purchaser's intention to sell gas from the reserves as soon as it obtained the Commission's approval for the necessary transportation facilities[9]—and properly concluded that there was sufficient development of the leaseholds to meet the *Rayne Field* test (Pet. App. 14b, 15b, 16b-17b).

Nor is there any merit to the suggestion that the Outer Continental Shelf Lands Act (OCSLA) makes Louisiana law (which does not recognize a sale of gas in place) applicable to the Ship Shoal sales. Section 4(a)(1) of that Act (Pet. App. B, 3a) expressly extends the "laws * * * of the United States"—including of course the Natural Gas Act—to the offshore region "to the same extent as if" it "were an area of exclusive Federal jurisdiction located within a State." And Section 4(a)(2) (Pet. App. B, 3a) provides that the laws of the adjacent States are to apply only "to the extent * * * not inconsistent with * * * other Federal laws." Louisiana's non-recognition of a sale of gas "in place" is inconsistent with the Natural Gas Act as interpreted by this Court in *Rayne Field*, and

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[9] As noted in the Statement, *supra*, p. 5, consideration of this application has been delayed pending final decision of the jurisdictional issue (*Tennessee Gas Transmission Co., supra*, 30 F.P.C. at 764-767).

is accordingly without force (Pet. App. 18b-20b). Moreover, nothing in the text or history of OCSLA suggests even remotely an intention to affect the federal regulation of sales by natural gas producers.[10]

[10] Petitioners' argument that the Commission, if it has jurisdiction here, could nullify the authority of the Secretary of the Interior in approving the transfer of the leaseholds by denying petitioners a certificate proves too much. For the same result would follow from the Commission's refusal to issue to Tennessee, the purchaser, a certificate for the construction of the facilities necessary to take the Ship Shoal gas—and the Commission's authority under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c) (Pet. App. A, 1a), to require such a certificate is unquestioned. Petitioners also complain that if the transaction is construed as a conventional sale, "with the products treated as 'production'", they will immediately become liable for a royalty of 1/6 of the value of the products sold (Pet. 17, n. 25). But the royalty is payable only on actual production (J.A. 93-94, 108-109). There is no basis for equating the sale of the reserves with the commencement of actual production; they are two quite different parts of the process of getting the gas from the ground to the burners.

CONCLUSION

Viewed in the light of this Court's recent *Rayne Field* and *Bastian Bay* decisions, the petition for a writ of certiorari presents no substantial question; it should therefore be denied.

Respectfully submitted.

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MAY 1967.

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